

General Information. Letter: General guidance on determination of the sales factor numerator.

May 2, 2005

Dear:

This is in response to your letter dated April 18, 2005, in which you request advice. Department of Revenue (“Department”) regulations require that the Department issue only two types of letter rulings, Private Letter Rulings (“PLRs”) and General Information Letters (“GILs”). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department, can be accessed at the Department’s website. That address is www.revenue.state.il.us/legalinformation/regs/part1200.

You have specifically requested a GIL in your letter. In addition, you further state as follows:

Facts

Consider a ‘brick and mortar’ type retail store (hereinafter ‘XYZ’ with locations in Illinois that cater almost entirely to a household consumer market. XYZ has retail stores located throughout the United States. XYZ has a store located in Illinois near the border of Illinois and State X. XYZ has nexus with, and files state income tax returns in, State X. XYZ sells tangible goods, including big ticket items (e.g., appliances, furniture, etc.) both to people living in Illinois and to people living in State X.

Specifically, XYZ makes product sales to State X customers under the following circumstances:

1. People who live in State X purchase products over the phone and the products are delivered via common carrier or XYZ delivery personnel to the customer’s home in State X.
2. People who live in State X purchase products over the phone and pick up purchased goods at the Illinois store location of XYZ.
3. People who live in State X purchase products in person at the Illinois store location of XYZ, and the products are delivered via common carrier or XYZ delivery personnel to their homes in State X.
4. People who live in State X purchase products in person at the Illinois store location of XYZ and take the products with them back to their homes in State X.

XYZ is aware as to almost all of its customers, including those described in Category 4, whether the customer lives in State X or in Illinois or in some other state. XYZ has this information from credit card receipts, which represent a large percentage of its sales, and/or from other

customer information procedures that occur at the point of sale, whether by telephone order or in person.

Issue

Given the facts described above, how would XYZ compute the sales factor numerator for its Illinois income tax return with respect to the sale of tangible personal property under the four scenarios described above?

This issue is governed by Illinois Income Tax Act (IITA) Section 304(a)(3), 35 ILCS 5/304(a)(3), which states:

(3) Sales factor.

(A) The sales factor is a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.

(B) Sales of tangible personal property are in this State if:

(i) The property is delivered or shipped to a purchaser, other than the United States government, within this State regardless of the f. o. b. point or other conditions of the sale; or

(ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this State and either the purchaser is the United States government or the person is not taxable in the state of the purchaser; provided, however, that premises owned or leased by a person who has independently contracted with the seller for the printing of newspapers, periodicals or books shall not be deemed to be an office, store, warehouse, factory or other place of storage for purposes of this Section. Sales of tangible personal property are not in this State if the seller and purchaser would be members of the same unitary business group but for the fact that either the seller or purchaser is a person with 80% or more of total business activity outside of the United States and the property is purchased for resale

Regulations promulgated under IITA Section 304(a)(3) expand upon this issue. IIT Reg. Section 100.3370(c), 86 Ill. Admin. Code 100.3370(c), states:

c) Numerator. The numerator of the sales factor shall include the gross receipts attributable to this State and derived by the person from transactions and activity in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incidental to such gross receipts shall be included regardless of the place where the accounting records are maintained or the location of the contract or other evidence of indebtedness.

1) Sales of tangible personal property in this State

A) Gross receipts from the sales of tangible personal property (except sales to the United States Government) (see 86 Ill. Adm. Code 100.3370(c)(2)) are in this State:

i) if the property is delivered or shipped to a purchaser within this State regardless of the f.o.b. point or other conditions of sale; or

ii) if the property is shipped from an office, store, warehouse, factory or other place of storage in this State and the taxpayer is not taxable in the state of the purchaser. However, premises owned or leased by a person who has independently contracted with the taxpayer for the printing of newspapers, periodicals or books shall not be deemed to be an office, store, warehouse, factory or other place of storage.

B) Property shall be deemed to be delivered or shipped to a purchaser within this State if the recipient is located in this State, even though the property is ordered from outside this State.

Example: A corporation, with inventory in State A, sold \$100,000 of its products to a purchaser having branch stores in several states including this State. The order for the purchase was placed by the purchaser's central purchasing department located in State B. \$25,000 of the purchase order was shipped directly to purchaser's branch store in this State. The branch store in this State is the "purchaser within this State" with respect to \$25,000 of the corporation's sales.

C) Property is delivered or shipped to a purchaser within this State if the shipment terminates in this State, even though the property is subsequently transferred by the purchaser to another state.

Example: A corporation makes a sale to a purchaser who maintains a central warehouse in this State at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the corporation's products shipped to the purchaser's warehouse in this State is property "delivered or shipped to a purchaser within this State".

D) The term "purchaser within this State" shall include the ultimate recipient of the property if the person in this State, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this State.

Example: A corporation in this State sold merchandise to a purchaser in State A. The corporation directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this State pursuant to purchaser's instructions. The sale by

the corporation is "in this State".

- E) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this State, the sales are in this State.

Example: Corporation X, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While en route the produce is diverted to the purchaser's place of business in this State in which state Corporation X is subject to tax. The sale by the corporation is attributed to this State.

- F) If the person is not taxable in the state of the purchaser, the sale is attributed to this State if the property is shipped from an office, store, warehouse, factory, or other place of storage in this State (subject to the exception noted in (c)(1)(A)(ii) above).

Example: A corporation has its head office and factory in State A. It maintains a branch office and inventory in this State. The corporation's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in this State for approval and are filled by shipment from the inventory in this State. Since the corporation is immune under Public Law 86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to this State, the state from which the merchandise was shipped. (emphasis added).

Section 304(a)(3)(B)(i) of the Illinois Income Tax Act (35 ILCS 5/304(a)(3)(B)(i)) provides that sales of tangible personal property are in Illinois if the property is delivered or shipped to a purchaser, other than the U.S. government, within this State, regardless of the f.o.b. point or other conditions of sale. See 86 Ill. Adm. Code § 100.3370(c)(1). The language of IITA Section 304(a)(3)(B)(i) is identical to that of Section 16(a) of the Uniform Division of Income for Tax Purposes Act (UDITPA). Section 16(a) of UDITPA was incorporated as article IV of the Multistate Tax Compact. The Official Commentary on the Illinois Income Tax Act states:

Article 3 of the Act provides rules for the allocation and apportionment of business income and non-business income between Illinois and other states. For the most part this is accomplished by embodying ... the principles of the Multistate Tax Compact which was adopted by Illinois effective July 1, 1967... . Adoption of the provisions of the Compact was believed desirable in the interests of interstate uniformity and consistency with existing Illinois law. (Caterpillar Tractor Company v. Lenckos, 84 Ill. 2d 102, 177 (1981), quoting OFFICIAL COMMENTARY ON THE ILLINOIS INCOME TAX ACT)

The majority of courts in UDITPA-based states hold that the term "within this state" in the sales factor for tangible personal property modifies the term "purchaser," rather than the term "delivered." For example, in McDonnell Douglas Corp. v. Franchise Tax Board, 26 Cal. App. 4th 1789 (Cal. Ct. App.

1994), the court held that Section 25135(a) of the California tax law should be read as imposing a "destination" rule, rather than a "place of delivery" rule, in computing the California sales factor. The court reasoned that the destination rule advanced the purpose of the sales factor to reflect the contribution of the consumer states to the production of income, and also promoted the goal of UDITPA to ensure uniformity among states in taxation matters. The court noted that a majority of courts in other UDITPA-based states held the same. *Department of Revenue v. Parker Banana Co.*, 391 So.2d 762 (Fla. Ct. App. 1980); *Pabst Brewing Co. v. Wis. Dept. of Revenue*, 387 N.W. 2d 121 (Wis. Ct. App. 1986); *Olympia Brewing Co. v. Com'r of Revenue*, 326 N.W. 2d 642 (Minn. 1982); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916 (Col. 1983); *Texaco, Inc. v. Groppo*, 574 A.2d 1293 (Conn. 1983) ("the uniform holding of courts in other states interpreting essentially identical language has been that the destination of goods, and not their delivery point is dispositive." *Id.* at 1297)); *Strickland v. Patcraft Mills, Inc.*, 302 S.E.2d 544 (Ga. 1983); *Revenue Cabinet v. Rohm & Hass Kentucky, Inc.*, 929 S.W.2d 741 (Ky. Ct. App. 1996) ("[W]e fail to perceive any valid reason why Kentucky, when interpreting the applicable Kentucky statutes, should adopt a minority view which is inconsistent with the destination rule uniformly adopted by other states." *Id.* at 745)).

Consistent with the purpose of the sales factor, and to promote the goal of uniformity among UDITPA states, the same "destination" rule shall apply for purposes of IITA Section 304(a)(3)(B)(i). Therefore, even though a taxpayer's customer may receive physical possession of the property outside Illinois, a sale may nonetheless constitute an Illinois sale where the destination of the property sold is Illinois. (See Cal. Franch. Tax Bd. Legal Ruling 95-3 (July 20, 1995) ("[I]f physical possession of goods is transferred by a seller to a purchaser in another state and the goods are taken by the purchaser into California to its place of business in this state, the sale is a California sale unless the seller is not taxable in this state. Because, in such a case, the property would not have been delivered in California, to be a California sale, the property must therefore have been 'shipped' to meet the conditions of Section 25135(a). Thus, to be consistent with the [McDonnell Douglas Corp.] holding, transportation by the purchaser, inclusive of transporting mobile property under its own power, must be considered 'shipment' to the purchaser within this state."))

In this case, with respect to each of the pick-up and delivery methods you have described, the destination of the goods sold is always State X. Since it is the destination of the sale rather than the method of pick-up and delivery that is dispositive of the Illinois sales factor, in each of the situations described in your ruling request the product sales of XYZ would not be included in the numerator of the Illinois sales factor.

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200.

Sincerely yours,

Jackson E. Donley,
Senior Counsel-Income Tax